

The Treasury

Budget 2013 Information Release

Release Document

July 2013

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report

MINISTRY OF
SOCIAL DEVELOPMENT
Te Manatū Whakahiato Ora



REP/13/5/352 and T2013/1167

Date: 7 May 2013
To: Hon Bill English, Minister of Finance
Hon Michael Woodhouse, Minister of Veterans' Affairs

JOINT MSD / TREASURY / DEFENCE FORCE REPORT: 2013 BUDGET ECONOMIC AND FISCAL UPDATE (BEFU) OF BENEFIT FORECASTS FOR VOTE VETERANS' AFFAIRS – SOCIAL DEVELOPMENT

Purpose of the report

1. This report has been prepared by the Ministry of Social Development (MSD) and seeks joint Ministerial approval for Vote Veterans' Affairs – Social Development forecast to be included in the 2013 Budget Economic and Fiscal Update (BEFU). Cabinet has delegated authority for approving the forecast to the Minister of Finance and the Minister of Veterans' Affairs [CO (11) 6 refers].
2. The Veteran's Pension (VP) forecast is the only item discussed in this report. Forecasts for related war pensions are outlined in the report for Vote Veterans' Affairs – Defence Force [REP/13/5/353 refers].
3. The current legal appropriation for Vote Veterans' Affairs – Social Development was set using the forecast prepared for the 2012 Half Year Economic and Fiscal Update (HYEFU) [REP/12/11/1173 and T2012/3100 dated 11 December 2012 refer]. These need to be updated using the forecast prepared for the 2013 BEFU.

Executive summary

4. Table 1 presents the revised VP forecast for the 2013 BEFU, incorporating all the changes discussed in this report.

Table 1: Budget Economic and Fiscal Update Benefit Forecasts

Vote Veterans' Affairs - Social Development: Benefits and Other Unrequited Expenses	Supplementary Estimates 2012/13 (\$000)	Estimated Actual 2012/13 (\$000)	2013/14 (\$000)	2014/15 (\$000)	2015/16 (\$000)	2016/17 (\$000)
	(A)	(B)	(C)	(D)	(E)	(F)
Veteran's Pension	172,319	171,319	167,008	158,577	154,228	147,930
Total 2013 BEFU Forecast	172,319	171,319	167,008	158,577	154,228	147,930

5. Forecast VP expenditure is revised down by \$796,000 (0.10%) over the five fiscal years to June 2017, compared to the 2012 HYEFU forecast. The decrease in forecast expenditure is mostly because of a downward revision to the forecast number of recipients.

6. The largest risk to the forecast is the introduction of Veterans' Weekly Income Compensation (VWIC) in July 2014, which will replace VP for some veterans. There is a risk that fewer than expected VP recipients will transfer to VWIC when it is introduced, so the savings to this Vote may be lower than expected.

Recommended actions

It is recommended that joint Ministers:

- 1 **note** that Cabinet has delegated authority for approving forecast changes to baselines to the Minister of Finance and the Minister of Veterans' Affairs [CO (11) 6 refers]. These forecasts will be incorporated in the 2013 BEFU that will be published on 16 May 2013
- 2 **note** that the baselines are already included in the Supplementary Estimates of Appropriations 2012/13 and Estimates of Appropriations 2013/14
- 3 **note** that the forecasts in this report are on a mid-point basis, and use available benefit information as at 13 April 2013, as well as Treasury's macroeconomic forecasts finalised on 11 April 2013
- 4 **note** that the 2012/13 amount in column B of Table 1 (on previous page) is the mid-point forecast that makes up the 'Estimated Actual' in the Estimates of Appropriations
- 5 **note** that the Supplementary Estimates of Appropriations 2012/13 (column A of Table 1) includes an 'add on' amount to reduce the likelihood of an overspend and the need for Parliamentary validation
- 6 **note** that under the current fiscal management approach the net impact of changes to forecasts will be counted against future operating allowances. The net impact will be determined once all between-budget economic and fiscal updates and baseline updates of forecasts of benefits and all other expenses are finalised
- 7 **note** that the 66% wage floor was reached in April 2012, and with the exception of April 2015, will be reached in every April of the forecast period

8 **approve** the revised baselines for 2012/13 to 2016/17 set out in column A and columns C to F of Table 1 (on front page)

Agree / Disagree

Agree / Disagree

9 **approve**, in accordance with CO (11) 6, the changes to appropriations for 2012/13 set out in Column A of Table 1 being met from imprest supply until Supplementary Estimates of Appropriations 2012/13 are enacted.

Agree / Disagree

Agree / Disagree

Fiona Carter-Giddings

Team Leader
Labour Market & Welfare
the Treasury

Date

Sue Mackwell

Deputy Chief Executive
Social Policy and Knowledge
Ministry of Social Development

Date

Hon Bill English

Minister of Finance

Date

Hon Michael Woodhouse

Minister of Veterans' Affairs

Date

2013 Budget Economic and Fiscal Update

Summary of changes

7. Overall, forecast expenditure is revised down by \$796,000 (0.10%) over the five years to June 2017, compared to the 2012 HYEUFU. Table 2 splits this revision into four components – demand driven changes, indexation, policy changes, and the supplementary estimates add-on.

Table 2: Contributions to Change in Veteran's Pension

Vote Veterans' Affairs - Social Development Veteran's Pension Expenditure	2012/13 (\$000)	2013/14 (\$000)	2014/15 (\$000)	2015/16 (\$000)	2016/17 (\$000)	Five Year Total (\$000)
2012 HYEUFU Forecast	171,658	167,492	158,645	154,849	148,214	800,858
Forecast Demand Driven Changes	(337)	(753)	(919)	(974)	(668)	(3,651)
Indexation Changes	4	285	868	279	300	1,736
Forecast Before Policy Changes	171,325	167,024	158,594	154,154	147,846	798,943
<i>Change from 2012 HYEUFU Before Policy</i>	<i>(333)</i>	<i>(468)</i>	<i>(51)</i>	<i>(695)</i>	<i>(368)</i>	<i>(1,915)</i>
Policy Changes	(6)	(16)	(17)	74	84	119
Forecast After Policy Changes	171,319	167,008	158,577	154,228	147,930	799,062
<i>Change from 2012 HYEUFU after Policy</i>	<i>(339)</i>	<i>(484)</i>	<i>(68)</i>	<i>(621)</i>	<i>(284)</i>	<i>(1,796)</i>
Supplementary Estimates add-on	1,000					1,000
2013 BEFU Forecast	172,319	167,008	158,577	154,228	147,930	800,062
<i>Total Change From 2012 HYEUFU</i>	<i>661</i>	<i>(484)</i>	<i>(68)</i>	<i>(621)</i>	<i>(284)</i>	<i>(796)</i>
<i>Percentage changes</i>	<i>0.39%</i>	<i>(0.29%)</i>	<i>(0.04%)</i>	<i>(0.40%)</i>	<i>(0.19%)</i>	<i>(0.10%)</i>

Note: The numbers in the table may not add up due to rounding.

8. *Forecast demand driven changes* contribute a decrease of \$3.651 million over the five years to June 2017. The most significant change is a downward revision to the forecast number of recipients. VP is granted to veterans who qualify for New Zealand Superannuation and receive a War Disablement Pension of at least 70% of the maximum rate of pension that would be payable for total disablement. In some circumstances VP can be granted to veterans under the age of 65, if the veteran is unable to work for a substantial period of time due to disability.

Predicting when veterans will meet these criteria is difficult, and grants can vary significantly from month to month. Grants have been falling relatively slowly since 2010, and at the 2012 HYEUFU the number of grants was forecast to flatten out at around 43 grants per month. However, since the 2012 HYEUFU the numbers of grants per month has been lower than expected, and as a result the forecast was revised down at the 2013 BEFU to an average of 37 grants per month.

Also contributing to the demand driven changes was a downward revision to the average payment rate (before indexation), which has been slightly below forecast since the 2012 HYEUFU. This is partly offset by a decrease in forecast Debt Establishments and Overseas Pension Recoveries.

9. *Indexation* contributes an increase of \$1.736 million over the five years to June 2017. This reflects revisions to Treasury's Consumers Price Index (CPI) and Average Ordinary-Time Weekly Earnings (average wage) forecasts.

VP rates are adjusted by movements in the CPI each year, with the December year CPI change used to adjust rates the following 1 April. After the CPI adjustment, if the payment rate for a married couple is not at least 66% of the net average wage ('wage floor'), it is set at 66%. Average wages are generally forecast to grow at a faster rate than inflation over the forecast period, so the VP payment rates are expected to be adjusted by the wage floor in all years through to April 2017, except in April 2015. As Treasury's wage forecast has increased since the 2012 HYEPU, indexation increases forecast expenditure.

Table 3: Comparison of the BEFU 2013 ad 2012 HYEPU Wage and Inflation Forecasts

	CPI (annual % change)		Weekly Wages (\$)*	
	2013 BEFU	2012 HYEPU	2013 BEFU	2012 HYEPU
December 2012	0.61%	1.1%	\$1,022.88	\$1,023.11
December 2013	1.6%	1.6%	\$1,050.69	\$1,043.29
December 2014	1.7%	2.1%	\$1,068.75	\$1,068.18
December 2015	1.7%	1.9%	\$1,094.93	\$1,094.45
December 2016	2.0%	2.1%	\$1,130.23	\$1,122.47

* Weekly Wages refers to the gross average ordinary-time weekly earnings (AOTWE) series.

10. *Policy changes* contribute an increase of \$119,000 over the five years to June 2017. Table 4 shows the contribution of the two new policies introduced at the 2013 BEFU. [13]

This is partly offset by the transfer of a current Veteran's Pension recipient to Special Annuity. This transfer was due to his special circumstances, and took place in mid February 2013. The transfer of this one client is expected to reduce VP expenditure by \$73,000 over the five years to June 2017.

Table 4: Impact of Policy Changes on Veteran's Pension

Policy Changes	2012/13 (\$000)	2013/14 (\$000)	2014/15 (\$000)	2015/16 (\$000)	2016/17 (\$000)	Five Year Total (\$000)
Portability - Cook Islands, Niue and Tokelau	-	-	-	91	101	192
Special Annuity - new person	(6)	(16)	(17)	(17)	(17)	(73)
Total Policy Changes	(6)	(16)	(17)	74	84	119

Note: The numbers in the table may not add up due to rounding.

11. *The supplementary estimates add-on* of \$1.000 million was added to the 2013 BEFU forecast for 2012/13 to reduce the risk of unappropriated expenditure. Without this add-on the five year change in expenditure would be a reduction of \$1.796 million (0.2%).

Forecast outlook for Veteran's Pension

12. Figure 1 compares the total expenditure on VP for the 2013 BEFU (using the estimated actual for 2013/13) with the 2012 HYEPU, while Figure 2 compares the forecast number of VP recipients. The number of recipients is revised down slightly from the 2012 HYEPU throughout the forecast period.
13. In July 2014, VWIC will be introduced as income support for veterans under the age of 65 who cannot work because of disability. This policy was introduced at the 2012 HYEPU as part of the Government's response to the Law Commission Review.¹ VWIC will replace VP for some veterans, so the number of VP recipients drops in July 2014 (Figure 2), with a corresponding reduction in expenditure from 2014/15 (Figure 1). VWIC will be paid as part of War Disablement Pension within Vote Defence Force.²

¹ NZLC R115 A New Support Scheme for Veterans: A Report on the Review of the War Pensions Act 1954. Policy changes described in SOC Min (12) 21/6F and confirmed in CAB Min (12) 35/6C.

² Benefits within Vote Veterans' Affairs – Defence Force will be transferred to Vote Defence Force from 1 July 2013.

Figure 1
Vote Veterans' Affairs - Social Development
VETERAN'S PENSION
Actual and Forecast Annual Expenditure

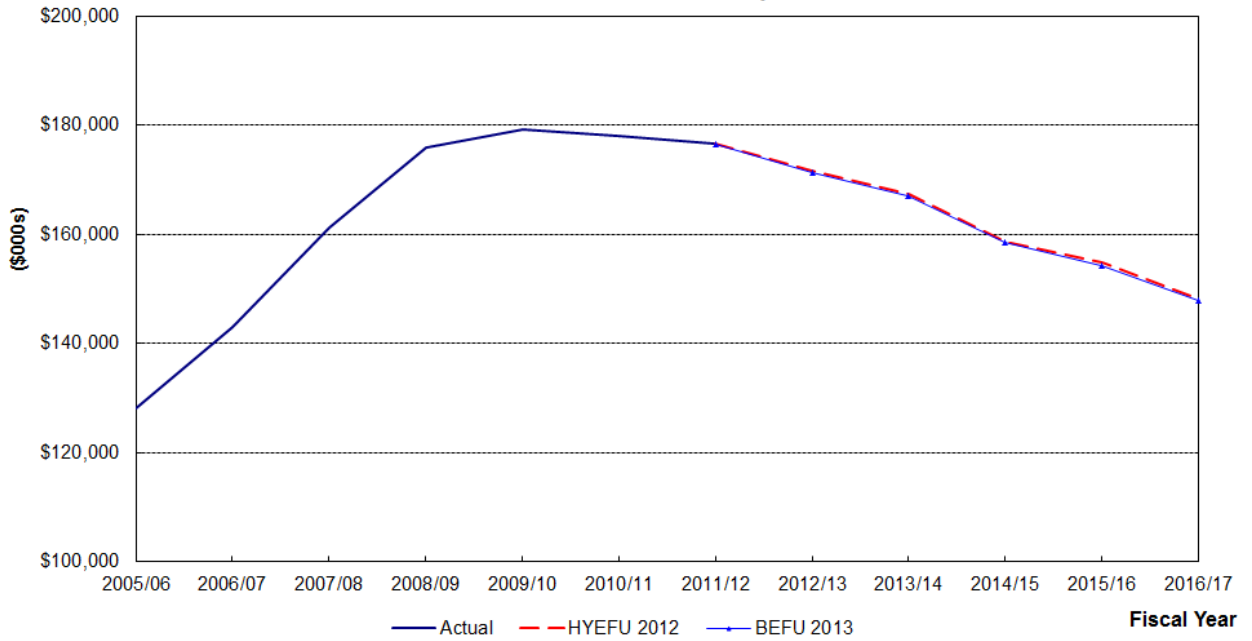
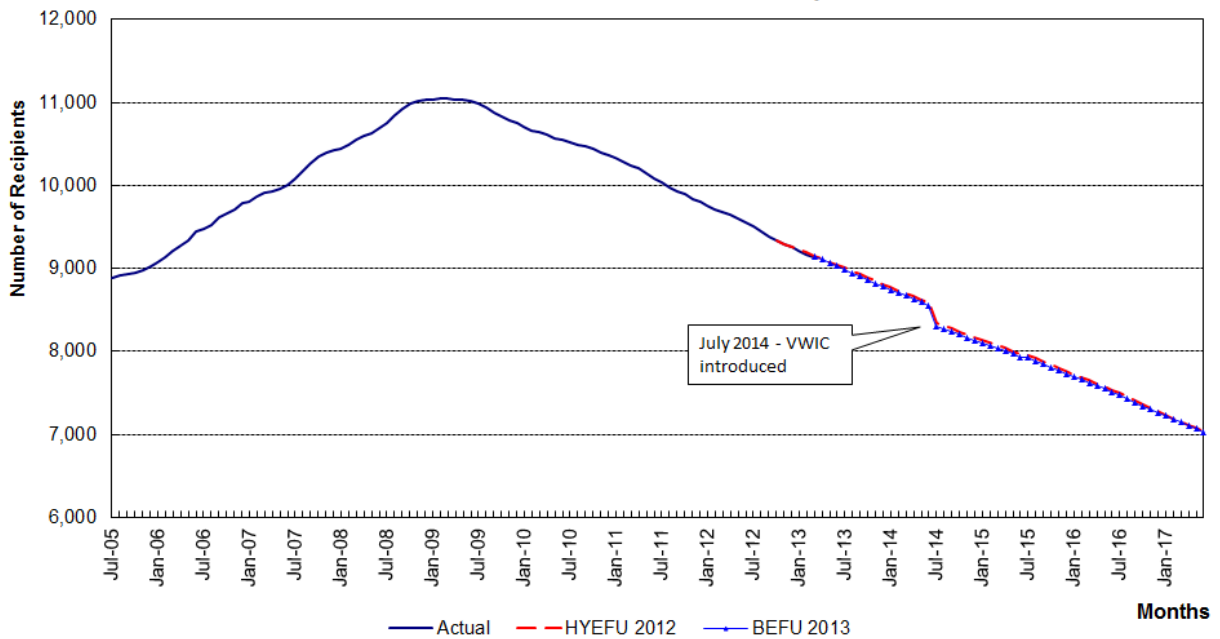


Figure 2
Vote Veterans' Affairs - Social Development
VETERAN'S PENSION
Actual and Forecast Number of Recipients



Risks to forecasts

Law Commission Review Risks

14. The main risk to the forecast is the introduction of VWIC in July 2014. The VWIC costing will be updated at the 2014 BEFU, and savings to this Vote may be revised.
 - The estimated number of VP recipients that will transfer to VWIC was based on the number of VP recipients younger than 65 in 2012. There are currently fewer VP recipients under the age 65 than there were at the time of the original costing. As a result, the estimated savings to this Vote from the introduction of VWIC may be reduced significantly when the costing is updated at the 2014 BEFU.
 - The savings from VWIC are also determined by the expected VP average rate from 2014/15 onwards. If CPI and wage growth over the forecast period turn out to be different to what was expected, then the actual savings to this Vote will differ to what is forecast.
 - Overall, there is a risk that the reduction in expenditure for this Vote will be lower than is currently expected.
15. The wider changes being made to WDP in response to the Law Commission review also present a risk to forecast VP expenditure. With the introduction of new support services, some WDP recipients may have their incapacity reassessed. It is possible that some current WDP recipients may become eligible for VP once their incapacity is reassessed. Others who currently qualify for VP may take this opportunity to transfer to VP from New Zealand Superannuation. This may result in a greater number of VP recipients than is expected, as well as a temporary change in trend.

General Risks

16. Any future campaigns that raise awareness of veterans' entitlements present a risk to the VP forecast, particularly if the forecasting team is not made aware of them in time. For example, letters sent in 2003 and 2008 to veterans informing them of potential eligibility for VP resulted in significant increases to the number of VP recipients.
17. Indexation can account for a sizeable fraction of total forecast revisions to expenditure. Unexpected inflation and/or average wage out-turns can cause significant forecast revisions.